QUESTIONS AND ANSWERS

BANK INDONESIA REGULATION NO.18/19/PBI/2016

FOREIGN EXCHANGE TRANSACTION AGAINST RUPIAH BETWEEN BANKS AND FOREIGN PARTY

1. **Q What is the background of the issuance of Bank Indonesia Regulation on Foreign Exchange Transaction against Rupiah between Banks and Foreign Party?**

   A This regulation is issued as Bank Indonesia's effort to encourage the acceleration of financial market deepening. One of the efforts is through the improvement of liquidity and instrument variations in the domestic foreign exchange market, among others are the development of derivative instruments of foreign currency against Rupiah. Furthermore, it is expected that market participants are encouraged to have a better risk management, especially market risk, through the use of derivative instruments of foreign currency against Rupiah that are developing in the market. Eventually, it is expected that efficiency of domestic foreign currency market and high resilience in facing market turbulences will be achieved in the near future.

2. **Q What are the matters specified in the regulation?**

   A This BI Regulation regulates among others:

   1. Amendment and combination of the earlier regulations: BI Regulation No. 16/17/PBI/2014, BI Regulation No. 17/7/PBI/2015, BI Regulation No. 17/14/PBI/2015 and BI Regulation No. 17/16/PBI/2015 to BI Regulation No. 18/19/PBI/2016.
   2. Exception to the prohibitions on structured products for foreign currency against Rupiah instruments, namely Call Spread Option under the following conditions:
      a. The category of banks which are allowed to conduct structured products foreign exchange transactions against Rupiah in the form of call spread option under the banking authority provisions should be at least banks with category of "BUKU 3".
      b. Any Bank making transaction of structured product between foreign currency and Rupiah in the form of Call Spread Option must apply the prudential principles in conducting structured product activities for commercial banks
      c. Structured product instruments for foreign currency against rupiah in the form of call spread option may be transacted between Bank and Foreign

Party for hedging purpose.

d. Structured product transactions for foreign currency against rupiah in the form of call spread option must have an underlying transaction and must be conducted in dynamic hedging if the Rupiah exchange rate has exceeded the level of call spread option rate.

As a result, BI Regulation No. 16/17/PBI/2014, BI Regulation No. 17/7/PBI/2015, BI Regulation No. 17/14/PBI/2015 and BI Regulation No. 17/16/PBI/2015 is repealed and substituted by BI Regulation No. 18/19/PBI/2016.

3. **Q** **Why is *call spread option* exempted in the prohibition for *structured product* against Rupiah?**

A Call spread option is allowed as an alternative instruments for a Foreign Party in hedging exchange rate exposure with more efficient cost, in line with the hedging obligation regulation in domestic in 2017.

4. **Q** **What is *call spread option?***

A Call Spread Option is a combination of buy call option and sell call option conducted simultaneously based on a transaction contract at a different strike price and the same nominal amount. The hedging cost with call spread option will be more efficient than forward transaction or plain vanilla option, however it has a limited exchange rate hedging range.

5 **Q** **What is *dynamic hedging* for *call spread?***

A *Dynamic hedging* for *call spread* is a transaction made by a Foreign Party by purchasing a call option on the sell call strike price of the previous call spread and selling a call option with a higher strike price. For example, if a Foreign Party in a call spread option transaction has a range from Rp13,000 to Rp14,000, the dynamic hedging will be conducted by purchasing a call at a strike price of Rp14,000 and selling a call at strike price of Rp15,000. On that dynamic hedging transaction, the exchange rate protection of the Foreign Party shifts from the range of Rp13,000 - Rp14,000 to Rp13,000 and Rp15,000.

The dynamic hedging transaction above is made to ensure the party doing the Call Spread Option transaction is not exposed to the exchange rate risk because of the market rate exceeds the range of the initial Call Spread Option rate.

6. **Q** **What are the requirements for *dynamic hedging?***

A *Dynamic hedging* must be conducted if the exchange rate is above the previous protection range, with the following requirements:

1. the range of the rate does not overlap the range of the initial Call Spread transaction rate;
2. the range of the rate does not have a gap with the range of the initial Call Spread Option transaction rate;
3. using the same undue Underlying Transaction;
4. the nominal is not cumulative;
5. time range:
    a. at least 6 (six) months for the initial Call Spread Option transaction with remaining due period of 6 (six) months or more; or
    b. follows the remaining due period of an initial Call Spread Option transaction with remaining due period less than 6 (six) months; and
6. is conducted no later than 1 (one) working day after the market rate exceeds the range of the initial Call Spread Option rate.

7. **Q** **Referring to the rule that foreign currency purchase may not exceed the nominal of an underlying, if a Foreign Party has a debt of $10 million and conduct a call spread transaction from the range of Rp13,000-Rp14,000, can the Foreign Party make a spot transaction of $10 million when the debt mature?**

A The Foreign Party may use the same call spread option Underlying to conduct a spot transaction when the debt mature.

8. **Q** **May early termination be applied to *call spread options?***

A Yes. Early termination may be applied to call spread options so that a Foreign Party may conduct cancellable call spread option transactions.